

State of Montana
Office of the Legislative Auditor

REPORT TO THE LEGISLATURE

BOARD OF INVESTMENTS

Financial-Compliance Audit

For the Fiscal Year Ended June 30, 1987

This report contains three recommendations related to the board's automated investment accounting systems. The recommendations address authorization of the system development arrangement, recording and tagging computer equipment to operate the system, and obtaining detailed users' manual for all automated systems. A fourth recommendation addresses accounting for bond swaps.

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Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office.

Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

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STATE OF MONTANA

Office of the Legislative Auditor

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December 1987

DEPUTY LEGISLATIVE AUDITORS

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FINANCIAL COMPLIANCE AUDITS

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PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Board of Investments for the fiscal year ending June 30, 1987. Included in this report are recommendations concerning authorization of the system development arrangement for the board's portfolio management system, recording and tagging computer hardware, obtaining users' manuals for all automated systems, and accounting for bond swaps. The board's responses are contained at the end of the report.

We thank the Executive Director and his staff for their assistance and cooperation.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat", written over a horizontal line.

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

BOARD OF INVESTMENTS

Financial-Compliance Audit
For the Fiscal Year Ended June 30, 1987

Audit staff involved in this audit include: Jody Alke, Mary Bryson,
Allyn Clark, Jim Manning, and Amy Vanica.



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STATE OF MONTANA
BOARD OF INVESTMENTS
APPOINTED AND ADMINISTRATIVE OFFICIALS
JUNE 30, 1987

BOARD OF INVESTMENTS*

<u>Member</u>	<u>Term Expires</u>
Joseph B. Reber, Chairman	January 1989
Robert L. Batista	January 1989
J. William Kearns	January 1989
Joel Long	January 1989
W.E. Schreiber	January 1991
Wilbur Scott	January 1991
Frederick B. Tossberg	January 1991

ADMINISTRATIVE OFFICIALS

David M. Lewis	Executive Director*
James R. Howeth	Investment Officer
James R. Penner	Assistant Investment Officer

- * The 1987 legislature created a new nine member Board of Investments (BOI) as of July 1, 1987, by abolishing the Montana Economic Development Board and the former BOI and transferring to the new BOI the functions of the abolished boards. The law also created the executive director position.

SUMMARY OF RECOMMENDATIONS

This listing serves as a means of summarizing the recommendations contained in the report and the audited agency's reply.

Page

Recommendation #1

The Board of Investments:

- A. Authorize future system development projects prior to initiation of such projects. 4

Agency Response: Concur. See page 36.

- B. Document its understanding of the soft dollar arrangement in the board minutes. 4

Agency Response: Concur. See page 36.

Recommendation #2

The Board of Investments:

- A. Obtain documentation transferring ownership of the computer hardware. 5

Agency Response: Concur. See page 36.

- B. Record computer hardware on the state accounting system. 5

Agency Response: Concur. See page 36.

- C. Tag donated equipment as state property in accordance with state policy. 5

Agency Response: Concur. See page 36.

Recommendation #3

The Board of Investments obtain or develop a users' policy and procedures manual for its existing and planned automated accounting systems. 6

Agency Response: Concur. See page 37.

SUMMARY OF RECOMMENDATIONS (continued)

	<u>Page</u>
<u>Recommendation #4</u>	
The Board of Investments record bond swap transactions in accordance with generally accepted accounting principles and state accounting policy.	7
Agency Response: Do not Concur. See page 37.	

INTRODUCTION

We performed a financial-compliance audit of the Montana Board of Investments (board) investment activities for the fiscal year ended June 30, 1987. The board's operating expenditures are included in a separate audit of the Department of Administration for the two fiscal years ended June 30, 1987. Article VIII, section 13, of the Montana Constitution requires an annual audit of the board and this report represents compliance with the annual audit requirement. The objectives of the audit were to:

- 1) determine if the board's investment financial statements fairly present the financial position and results of operations for the fiscal year ended June 30, 1987;
- 2) determine if the board complied with applicable laws and regulations;
- 3) review the board's management and investment accounting control systems and make recommendations for improvements in the management and internal controls of the board; and
- 4) determine the implementation status of prior audit recommendations.

This report contains four recommendations to the board. These recommendations address areas where management, financial reporting, and compliance with laws and regulations can be improved. Other areas of concern deemed not to have a significant effect on operations of the Board of Investments are not specifically included in the report, but have been discussed with the executive director and his staff.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in the report.

BACKGROUND

The Montana Board of Investments was created by the Executive Reorganization Act of 1971 and has the primary authority to invest state funds. Chapter 581, Laws of 1987, created a new Board of Investments within the Department of Commerce by abolishing the Montana Economic Development Board and the former Board of Investments of the Department of Administration. The law transferred to the new Board of Investments the

functions of the abolished boards. As of July 1, 1987, the board consists of nine members appointed by the Governor.

The Board of Investments (board) employs an executive director, investment officer, and assistant investment officer, and they in turn hire and manage the other staff of the board. The staff advise the board, implement its decisions, and perform daily investment and record-keeping functions. Administrative charges to investing members fund the Board of Investments' operations. These fees are collected from income earned on monies invested.

The board directs the investment of state funds in accordance with the constitution and laws of the state. The board administers the investment program under the prudent expert principle which requires an investment manager to: discharge his duties with the care, skill, prudence, and diligence, under the circumstances prevailing, that a prudent person in a like capacity with the same resources and familiarity exercises; diversify the holdings of each participating fund to minimize the risk of loss and to maximize the rate of return; and discharge his duties solely in the interest of and benefit for the funds forming the unified investment program.

There are three major investment management programs within the board's operations. "All Other Funds" is a combination of approximately 50 separate investment funds. The investments are directly owned by the state agencies and managed on their behalf by the board. The investments, generally long-term in nature, are managed to produce steady yields over a long period of time.

The "Short-Term Investment Pool" (STIP) provides a short-term investment vehicle to state or local government investors. Formerly there were two short-term investment pools: STIP for state agency investors, and STIP II for local government investors. On January 30, 1987, STIP participants sold their STIP units and purchased STIP II units. This conversion resulted in a single fixed unit value short-term investment pool called STIP. The purpose of STIP is to provide the highest possible return, yet maintain a highly liquid position. The short-term investment portfolio is managed by the board, and participants may purchase or sell units on a daily basis.

The "Montana Common Stock Pool" (Mont-Comp) is an investment pool designed to allow authorized agencies to participate in the equity market via a diversified pool. The Montana Constitution authorizes only the retirement

funds to invest in private corporate capital stock. The board manages the securities in the portfolio, and participants purchase units on a monthly basis.

AUTOMATED INVESTMENT ACCOUNTING SYSTEM

In 1983, the board entered into a \$305,000 contract with a private computer services company to develop an investment accounting and portfolio management system for all three investment programs. The contract called for a completion date between September 1984 and February 1985, and required the computer services company to obtain a performance bond for the full amount of the contract. In October 1985, the board retained the services of a local computer consulting firm to examine the system and develop procedures for testing it. Our fiscal year 1985 audit report contained recommendations related to the board's procedures and contract arrangement concerning this software development project. In our fiscal year 1986 audit report we noted that the system was not yet operational because of delays and pending resolution with the private company we made no recommendation. Issues similar to those presented in the fiscal year 1985 report are again discussed in this report.

Authorization and Documentation

During fiscal year 1987, the board determined that the automated investment accounting system would not be operational. In February and in April 1987, the board's attorney informed the performance bond holder that the board desired to call the bond due to lack of performance on the contract. As of October 6, 1987, this issue had not been resolved and the board considered legal action. Subsequently, the bond holder posted the bond, and in December 1987 the board settled with the computer firm for \$127,500.

In January 1986, pending resolution of the dispute with the computer firm and the bond holder, board personnel entered into an arrangement whereby the local computer consulting firm proceeded with development of automated investment accounting systems at a total proposed cost of \$240,000. A local broker used by the board for investment transactions agreed to pay the computer firm. This practice, referred to as a "soft dollar" arrangement, is common in the investment industry and is authorized by 17 CFR, Part 241,

Section 28(e), Securities and Exchange Commission (SEC). This section permits money managers to use commission dollars to obtain investment research and brokerage services. The board's attorney issued a legal opinion in March 1987 stating that although the board is not subject to SEC regulations, the soft dollar arrangement was in compliance with applicable state and federal laws. Such an arrangement was subsequently authorized by House Bill 2, Session Laws of 1987:

The board of investments may utilize designated commissions paid on the purchase and sale of securities for products and services customarily provided by brokers for such transactions according to applicable securities industries rules and regulations and Montana statutes.

The legislative authorization was effective July 1, 1987.

We found no documentation to indicate the board was formally notified of this arrangement until the February 1987 board meeting. By that time the board had received \$180,439 of services and equipment from the local firm. The automated system under development at the board has been acquired solely through commission dollars. The board did not use its own funds and therefore did not obtain expenditure authority from the legislature.

There is no formal written agreement between the board and the local computer consulting firm. SEC regulations state that a fiduciary customer (the board) cannot mandate the soft dollar services to be received from a broker, thereby precluding a written contract for those services. To protect the interests of the board, and to clarify such issues as ownership of the software/hardware at the completion of system development and potential services to be provided, the board should document their understanding and approval of such transactions in the board minutes.

RECOMMENDATION #1

WE RECOMMEND THE BOARD OF INVESTMENTS:

- A. AUTHORIZE FUTURE SYSTEM DEVELOPMENT PROJECTS PRIOR TO INITIATION OF SUCH PROJECTS.
- B. DOCUMENT ITS UNDERSTANDING OF THE SOFT DOLLAR ARRANGEMENT IN THE BOARD MINUTES.

Computer Hardware

During fiscal year 1987, the board received \$23,889 of computer hardware from the computer consulting firm through the soft dollar arrangement. There is no documentation indicating transfer of ownership from the firm to the board. Because actual payment for the equipment was not made, it should be treated as donated assets. The equipment is not recorded on the state accounting system, nor is it tagged as state property.

State policy requires that donated assets be recorded on the state accounting system at estimated fair market value on the date the asset is received, as determined from a receipt, letter, or other document. State policy also stipulates that each fixed asset will be assigned a property number and a corresponding property tag.

RECOMMENDATION #2

WE RECOMMEND THE BOARD OF INVESTMENTS:

- A. OBTAIN DOCUMENTATION TRANSFERRING OWNERSHIP OF THE COMPUTER HARDWARE.
- B. RECORD COMPUTER HARDWARE ON THE STATE ACCOUNTING SYSTEM.
- C. TAG DONATED EQUIPMENT AS STATE PROPERTY IN ACCORDANCE WITH STATE POLICY.

Systems Users' Manuals

The local computer consulting firm has successfully developed an automated STIP accounting system, which has been fully operational since January 1987. As of the opinion date, a Mont-Comp system is in the testing phase, and will run concurrently with manual records for a period of three months before becoming fully operational. The All Other Funds system is still under development.

During our audit, we found that although the STIP system had been operational for over six months, there was only a rough draft version of a users' policy and procedure manual. A users' manual provides a central source of information and helps to ensure consistent use of the system. Board

personnel indicated that significant additions and explanations must be added to the systems manual before it can be used.

One specific item that should be addressed in the users' manual is control over access. The password used to access the STIP system had not been changed since the system's inception. The password should be changed periodically to ensure that unauthorized persons do not have access. In response to an interim audit communication, board personnel indicated that necessary programming has been completed to facilitate password changing and would soon be implemented. Because corrective action has been taken, we make no recommendation concerning password changes.

RECOMMENDATION #3

WE RECOMMEND THE BOARD OF INVESTMENTS OBTAIN OR DEVELOP A USERS' POLICY AND PROCEDURES MANUAL FOR ITS EXISTING AND PLANNED AUTOMATED ACCOUNTING SYSTEMS.

BOND SWAPS

Bond swaps involve trading fixed income securities for other fixed income securities having the same par value for the purpose of enhancing portfolio content, but primarily to improve yield. Because of increasing interest rates in prior years, the market value of older securities declined. As a result the exchange of securities often gave rise to a loss on disposal of the older security. Conversely, decreasing interest rates, as experienced in the last two years, resulted in net gains from bond swap transactions during the current period.

There are two ways of accounting for gains and losses on exchanges of securities. One method, known as the completed transaction method, recognizes the gain or loss on a sale of a security at the time of the sale. The other method, the deferral and amortization method, recognizes a deferred gain or loss at the time of the sale and amortizes the deferral over the remaining life of the new (or old) bond.

The Board of Investments uses the deferral method in accounting for bond swaps. However, generally accepted accounting principles and state

accounting policy require bond swap gains and losses be recorded using the completed transaction method except for public employee retirement systems.

We identified this problem in prior audit reports and beginning in fiscal year 1985-86 bond swap transactions were accounted for on the Statewide Budgeting and Accounting System (SBAS) in accordance with generally accepted accounting principles. This complies with state law which requires the state's accounting records to reflect compliance with generally accepted accounting principles. The board has not changed its method of reporting bond swaps for the financial statements presented by the board. The All Other Funds financial statements for the board do not agree to SBAS and are not in accordance with generally accepted accounting principles. As a result of deferring bond swap gains and losses the board's All Other Funds financial statements are misstated by the following amounts:

	Amount Over/(Under)	
	<u>1987</u>	<u>1986</u>
Total Investments Managed -		
Beginning of Year	\$9,554,629	\$12,884,263
Net Investment Income	(2,989,465)	(3,329,634)
Net Unamortized Deferred Losses		
on Bond Swaps and Total Investments Managed End of Year	6,565,164	9,554,629

In order to present financial statements in accordance with generally accepted accounting principles and eliminate the differences between SBAS and board amounts, the board should adopt the completed transaction method for recording bond swaps for entities that are not public employee retirement systems.

RECOMMENDATION #4

WE RECOMMEND THE BOARD OF INVESTMENTS RECORD BOND SWAP TRANSACTIONS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND STATE ACCOUNTING POLICY.

PRIOR AUDIT RECOMMENDATIONS

Our office performed the Board of Investment audit for the fiscal year ended June 30, 1986. The report contained three recommendations still

applicable to the board's operations. The board implemented all three recommendations.

AUDITOR'S OPINION LETTERS
AND AGENCY FINANCIAL STATEMENTS

SUMMARY OF AUDIT OPINIONS

The auditor's opinions issued on All Other Funds, Short-Term Investment Pool, and Montana Common Stock Pool are intended to convey to the reader of the financial statements the degree of reliance which can be placed on the amounts presented. The Schedule of Investment Income (page 33 through 35) is presented for additional analysis and disclosure purposes as discussed in our opinion on page 32. Except for the specific item discussed in the auditor's opinion on page 9, the reader may rely on the fairness of the amounts presented on the statements listed in paragraph one of each of the auditor's opinions on pages 9, 18, and 26, when analyzing the Board of Investments investment activities.

STATE OF MONTANA
BOARD OF INVESTMENTS

ALL OTHER FUNDS

FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

STATE OF MONTANA

Office of the Legislative Auditor



SCOTT A SEACAT
LEGISLATIVE AUDITOR

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FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments All Other Funds as of June 30, 1987 and 1986, and the related Statement of Investment Income and Statement of Changes in Investments Managed for the two fiscal years then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures we considered necessary in the circumstances.

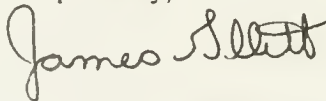
The Board of Investments follows the practice of deferring gains and losses incurred on bond swaps and amortizing those gains and losses over future periods. (See Note 2 to the financial statements.) Generally accepted accounting principles require that bond swap losses be recognized in the year incurred for all agencies, except for Public Retirement Systems where it is acceptable to defer gains and losses on bond swaps. As a result of deferring bond swap gains and losses, the financial statements are misstated by the following amounts:

	<u>Amount Over/(Under)</u>	
	<u>1987</u>	<u>1986</u>
Total Investments Managed-		
Beginning of Year	\$9,554,629	\$12,884,263
Net Investment Income	(2,989,465)	(3,329,634)
Net Unamortized Deferred Losses		
on Bond Swaps and Total Invest-		
ments Managed End of Year	6,565,164	9,554,629

In our opinion, except for the effect of deferring gains and losses on bond swaps as discussed in the preceding paragraph, the financial statements

referred to above present fairly the investments managed by the State of Montana Board of Investments All Other Funds as of June 30, 1987 and 1986, and its investment income and changes in its investments managed for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Respectfully,

A handwritten signature in dark ink, appearing to read "James Gillett". The signature is written in a cursive, flowing style with a large initial "J".

James Gillett, CPA
Deputy Legislative Auditor

October 6, 1987

STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS
STATEMENT OF INVESTMENTS MANAGED
JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Investments managed at book value (current value of \$1,720,983,180 in 1987 and \$1,960,697,997 in 1986) (Note 2)	\$1,665,434,029	\$1,806,679,044
Dividends and interest receivable	41,312,489	41,638,552
Net unamortized deferred losses on bond swaps (Note 2)	23,803,134	31,172,695
Interest purchased receivable	<u>1,884,957</u>	<u>1,496,361</u>
TOTAL INVESTMENTS MANAGED	<u>\$1,732,434,609</u>	<u>\$1,880,986,652</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS
STATEMENT OF INVESTMENT INCOME
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Income:		
Interest income	\$185,948,644	\$192,462,175
Dividend income	19,296	5,106
Realized gain on sale of investments	27,826,842	23,856,384
Rental income	<u>35,438</u>	<u>32,412</u>
Total Income	<u>213,830,220</u>	<u>216,356,077</u>
Expenses:		
Administrative expenses	(519,372)	(577,019)
Net amortization of deferred losses on bond swaps (Note 2)	<u>(2,613,269)</u>	<u>(3,365,202)</u>
Total Expenses	<u>(3,132,641)</u>	<u>(3,942,221)</u>
NET INVESTMENT INCOME	<u>\$210,697,579</u>	<u>\$212,413,856</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS
STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	1987	1986
TOTAL INVESTMENTS MANAGED BEGINNING OF YEAR	\$1,880,986,652	\$1,699,558,429
Net investment income	\$ 210,697,579	\$ 212,413,856
Income remitted to agencies	<u>(211,023,642)</u>	<u>(212,457,276)</u>
Increase (decrease) in dividends and interest receivable	(326,063)	(43,420)
Interest purchased during the year	4,983,867	5,690,003
Collection of interest purchased during the year	<u>(4,595,271)</u>	<u>(5,410,125)</u>
Increase (decrease) in interest purchased receivable	388,596	279,878
Net bond swap gains/losses incurred during the year	(4,756,292)	(8,155,172)
Net amortization of deferred bond swap losses	<u>(2,613,269)</u>	<u>(3,365,202)</u>
Increase (decrease) in net unamortized deferred gains/losses on bond swaps	(7,369,561)	(11,520,374)
Increase in book value of investments due to net amortization of discounts and premiums	2,342,010	3,661,033
Investments purchased	10,147,748,975	7,585,602,329
Investments sold, matured, and called	<u>(10,291,336,000)</u>	<u>(7,396,551,223)</u>
Increase (decrease) in book value of investments purchased	<u>(143,587,025)</u>	<u>189,051,106</u>
TOTAL INVESTMENTS MANAGED END OF YEAR	<u>\$ 1,732,434,609</u>	<u>\$1,880,986,652</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS

ALL OTHER FUNDS

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

1. HISTORY AND ORGANIZATION

The state of Montana Board of Investments (the board) was created by an act of the Legislature to invest and manage the state of Montana's investment funds on a centralized basis. The investments and the income therefrom are owned by various state agencies and managed on their behalf by the board.

State law mandates the board operate under the "prudent expert principle" diversifying holdings of each fund to minimize risk of loss and maximize rate of return. Common Stock purchases are restricted to pension funds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

Investments are presented in the statement of investments managed at book value (original cost adjusted for discount and premium amortization where applicable). Premiums and discounts are amortized using the straight-line method over the life of the securities. An average life of eight years is used for amortization of mortgage discounts.

Current values for publicly traded securities are determined primarily by reference to market prices supplied to the board by various brokerage houses. The investments managed related principally to investments which will be held or otherwise disposed of at no significant loss to the fund.

Bond Swaps

Bond swaps involve trading one security for another security having the same par value for the purpose of enhancing portfolio content and/or yield. The board defers gains and losses resulting from bond swaps and amortizes such gains and losses over the shorter of either the remaining life of the bonds sold or the replacement bonds purchased. As shown in the accompanying financial statements the accumulated net unamortized deferred losses on

bond swaps as of June 30, 1987 and 1986, and the net amortization of the deferred losses on bond swaps for the years then ended were as follows:

	<u>June 30, 1987</u>	<u>June 30, 1986</u>
Accumulated net unamortized losses on bond swaps:		
Agencies other than Public Retirement Systems,	\$ 6,565,164	\$ 9,554,629
Public Retirement Systems	<u>17,237,970</u>	<u>21,618,066</u>
Total	\$23,803,134	\$ 31,172,695
Net amortization of deferred losses on bond swaps:		
Agencies other than Public Retirement Systems	\$ 933,164	\$ 1,214,494
Public Retirement Systems	<u>1,680,105</u>	<u>2,150,708</u>
Total	\$2,613,269	\$ 3,365,202

3. INVESTMENTS NOT UNDER DIRECT CONTROL

Land and buildings, the costs of which are also included in investments managed in the accompanying financial statements, are not under direct control of the board. The agencies administering these assets maintain control and provide the board with the necessary financial information. Rental income from these buildings is included in the statement of investment income; however, occupancy and depreciation charges relating to the buildings are not material and have not been included in the statement of investment income.

The book value of land and buildings included in investments managed in the accompanying financial statements was \$250,265 at June 30, 1987 and \$258,709 at June 30, 1986.

4. SECURITIES LENDING

The board has an agreement with Chase Manhattan Bank (Chase) whereby Chase would loan to other entities securities managed by the board. During the period the securities are on loan, the board receives a fee and Chase must maintain collateral equal to 102 percent of the market value of the securities loaned. The board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial statements is \$418,328 for the year ended June 30, 1987 and \$580,393 for the year ended

June 30, 1986 of income from securities lending activities. At June 30, 1987 approximately \$152,042,077 and at June 30, 1986 approximately \$117,447,766 of securities included in these financial statements had been loaned by Chase to other entities.

5. LOAN GUARANTEES

On June 26, 1986, and January 30, 1987, the board entered into irrevocable loan agreements with the Economic Development Board (EDB) to lend money to EDB for deposit to the debt service reserve fund in amounts equal to the deficiency therein.

Bonds covered by this agreement were issued for \$27,480,000 on July 15, 1986, in the Cash Anticipation Financing Program and \$6,500,000 on March 16, 1987, in the Intermediate Term Capital Program. Maturity dates of the bonds are December 30, 1988, and March 1, 1995, respectively.

6. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized to give an indication of the level of risk assumed at June 30, 1987. Category 1 includes investments that are insured or registered or securities that are held by the entity or its agent in the entity's name. Category 2 includes uninsured or unregistered securities held by the counterparty trust department or agent in the entity's name (i.e., securities on loan).

Long-term investments are carried at book value and short-term investments are carried at original cost.

Long-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Government Securities	\$ 290,534,576	\$ 72,487,094	\$ 363,021,670	\$ 391,280,779
Corporate Bonds	974,414,605	71,218,176	1,045,632,781	1,057,687,433
Canadian Bonds	84,528,955	4,061,076	88,590,031	103,652,704
Mortgages	115,595,773		115,595,773	115,595,773
Other Bonds	<u>1,437,581</u>		<u>1,437,581</u>	<u>1,437,581</u>
TOTAL LONG-TERM	<u>\$1,466,511,490</u>	<u>\$147,766,346</u>	<u>\$1,614,277,836</u>	<u>\$1,669,654,270</u>

Short-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Corporate Stocks	\$ 904,266		\$ 904,266	\$ 891,793
Repurchase Agreements	39,098,000		39,098,000	39,098,000
Bankers' Acceptances	2,968,863		2,968,863	2,991,420
Commercial Paper	4,967,164		4,967,164	4,989,690
Government Securities	<u>383,823</u>	<u>\$ 2,834,077</u>	<u>3,217,900</u>	<u>3,358,007</u>
TOTAL SHORT-TERM	<u>\$ 48,322,116</u>	<u>\$ 2,834,077</u>	<u>\$ 51,156,193</u>	<u>\$ 51,328,910</u>
GRAND TOTAL	<u>\$1,514,833,606</u>	<u>\$150,600,423</u>	<u>\$1,665,434,029</u>	<u>\$1,720,983,180</u>

7. SUBSEQUENT EVENT

Effective July 1, 1987, Chapter 581, Laws of 1987, merged the Economic Development Board with the Board of Investments. A new nine-member board was established to oversee the entire investment program.

STATE OF MONTANA
BOARD OF INVESTMENTS

SHORT-TERM INVESTMENT POOL

FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

STATE OF MONTANA

Office of the Legislative Auditor



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

DEPUTY LEGISLATIVE AUDITORS

JAMES GILLETT
FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments Short-Term Investment Pool as of June 30, 1987 and 1986, the related Statement of Investment Income and Distributions and Statement of Changes in Investments Managed for the two fiscal years then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to in paragraph one present fairly the investments managed by the State of Montana Board of Investments Short-Term Investment Pool as of June 30, 1987 and 1986, and its investment income and changes in its investments managed for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Respectfully,

A handwritten signature in cursive script, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 6, 1987

STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL
STATEMENT OF INVESTMENTS MANAGED
JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Cash	\$ 144,730	\$ 10,375
Accounts receivable	625,653	
Interest receivable	4,449,718	31,071
Investments managed at cost (on June 30 approximate market value of \$633,941,618 in 1987 and \$16,279,204 in 1986)	<u>630,121,350</u>	<u>16,250,697</u>
TOTAL ASSETS	635,341,451	16,292,143
Accrued expenses	(22,346)	-0-
Income due participants	<u>(141,705)</u>	<u>(3,843)</u>
NET ASSET VALUE (see Note 2)	<u>\$635,177,400</u>	<u>\$16,288,300</u>
Units outstanding	6,351,774	162,883
Unit value	\$100.02	\$100.02

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL
STATEMENT OF INVESTMENT INCOME AND DISTRIBUTIONS
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Interest income	\$21,423,309	\$1,104,390
Administrative expenses (Note 2)	(271,016)	-0-
Income purchased by participants	3,727,233	36,098
Income due participants, beginning of year	3,843	5,114
Income due participants, beginning of year (Note 2)	<u>1,105,839</u>	<u> </u>
Income available for distribution	<u>25,989,208</u>	<u>1,145,602</u>
Income distributed on units sold (Note 2)	5,269,809	27,657
Distribution (Note 2)	<u>20,577,694</u>	<u>1,114,102</u>
Total distributions	<u>25,847,503</u>	<u>1,141,759</u>
Income due participants, end of year	<u>\$ 141,705</u>	<u>\$ 3,843</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
SHORT-TERM INVESTMENT POOL
STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Net asset value, beginning of year	\$ 16,288,300	\$ 9,055,400
Net asset value, beginning of year (see Note 2)	187,188,516	
Value of units purchased by participants	1,146,964,369	16,156,300
Changes in current value of investments managed	(867,821)	
Value of units sold by participants	<u>(714,395,964)</u>	<u>(8,923,400)</u>
Net asset value, end of year	<u>\$ 635,177,400</u>	<u>\$16,288,300</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS

SHORT-TERM INVESTMENT POOL

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

1. HISTORY AND ORGANIZATION

The state of Montana Board of Investments (board) was created by an act of the Legislature to invest and manage the state of Montana's investment funds on a centralized basis.

The Short-Term Investment Pool II (STIP II) was implemented on May 31, 1985 for local government participation. On January 30, 1987, Short-Term Investment Pool (STIP) participants sold their STIP units and purchased STIP II units. This conversion resulted in one operating pool which is called STIP.

The purpose of STIP is to obtain the highest possible return, yet maintain a highly liquid position whereby funds may be invested for relatively short periods, one day or more, depending upon the participant's anticipated use of the funds. The investments and the income of STIP are owned by the participants as they purchase units and are managed on their behalf by the board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The STIP unit value is fixed at \$100. The total price to buy or sell a unit is \$100 plus income accrued per unit since the last distribution. Income is distributed on the last business day of each month. Participants have the option of having the income automatically reinvested in additional units.

A unit purchased by a participant begins accruing income on the day it is purchased and ceases to accrue income on the day before the unit is sold. Participants who sell units between distribution dates receive the respective investment income in the total price of the unit on the date of sale.

Administrative expenses incurred by the board are charged to STIP daily based on the board's expenses applicable to STIP.

The portfolio of investments in STIP is kept under one year in maturity and is carried at cost or amortized cost where applicable. This portfolio structure allows for the fixing of the worth of the unit.

Formerly there were two short-term investments pools: STIP for state agency investors and STIP II for local government investors. On January 30, 1987, STIP participants sold their units and purchased STIP II units. This conversion resulted in a single fixed unit value short-term investment pool, called STIP.

The following represent the investments managed in the old Short-Term Investment Pool at June 30, 1986 before the conversion to the fixed unit value pool:

<u>INVESTMENTS MANAGED</u> <u>JUNE 30, 1986</u>	
	<u>1986</u>
Cash	\$ 22,863
Interest receivable	1,869,592
Investments managed at current value (cost of \$184,739,393 in 1986)	<u>186,425,736</u>
TOTAL ASSETS	188,318,191
Accrued expenses	<u>(23,836)</u>
Value of units	188,294,355
Income due participants	<u>(1,105,839)</u>
NET ASSET VALUE	<u>\$187,188,516</u>
Units Outstanding	193,938
Unit Value	\$970.90

CHANGES IN INVESTMENTS MANAGED
FOR THE FISCAL YEAR ENDED JUNE 30, 1986

	<u>1986</u>
Net asset value, beginning of year	\$248,447,814
Value of units purchased by participants	254,086,181
Changes in current value of investments managed	(1,761,482)
Value of units sold by participants	<u>(313,583,997)</u>
Net asset value, end of year	<u>\$187,188,516</u>

INVESTMENT INCOME AND DISTRIBUTIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 1986

	<u>1986</u>
Interest income	\$19,726,897
Administrative expenses	<u>(271,881)</u>
Net income	19,455,016
Income purchased by participants	5,341,031
Income due participants, beginning of year	<u>1,815,756</u>
Income available for distribution	<u>26,611,803</u>
Income distributed on units sold	6,728,348
*November distribution	10,828,192
*May distribution	<u>7,949,424</u>
Total distributions	<u>25,505,964</u>
Income due participants, end of year	<u>\$ 1,105,839</u>

*Before the conversion to the fixed unit value pool, cash distributions of income were made only twice a year.

3. SECURITIES LENDING

The board has an agreement with the Chase Manhattan Bank (Chase) whereby Chase would loan to other entities securities managed by the board. During the period the securities are on loan, the board receives a fee and Chase must maintain collateral equal to 102 percent of the market value of the securities loaned. The board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial statements is \$6,130 for the year ended June 30, 1987 and \$90,092 for the year ended June 30, 1986 of income from securities lending activities. At June 30, 1987 approximately \$16,686,750 and at June 30, 1986 approximately \$8,100,751 of securities included in these financial statements had been loaned by Chase to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized to give an indication of the level of risk assumed at June 30, 1987. Category I includes investments that are insured or registered or securities that are held by the entity or its agent

in the entity's name. Category 2 includes uninsured or unregistered securities held by the counterparty trust department or agent in the entity's name (i.e., securities on loan).

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Total Carrying Amount</u>	<u>Total Market Value</u>
Bankers'				
Acceptance	\$227,915,755		\$227,915,755	\$229,753,895
Commercial Paper	249,719,315		249,719,315	251,391,263
Corporate				
Obligations	9,997,500		9,997,500	10,036,100
Montana Certifi-				
cates of Deposit	16,777,500		16,777,500	16,777,500
Government				
Securities	56,122,530	\$16,686,750	72,809,280	73,080,860
Repurchase				
Agreements	52,902,000		52,902,000	52,902,000
	<u>\$613,434,600</u>	<u>\$16,686,750</u>	<u>\$630,121,350</u>	<u>\$633,941,618</u>

5. SUBSEQUENT EVENT

Effective July 1, 1987, Chapter 581, Laws of 1987, merged the Economic Development Board with the Board of Investments. A new nine-member board was established to oversee the entire investment program.

STATE OF MONTANA
BOARD OF INVESTMENTS

MONTANA COMMON STOCK POOL

FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

STATE OF MONTANA

Office of the Legislative Auditor



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

DEPUTY LEGISLATIVE AUDITORS

JAMES GILLETT
FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Statement of Investments Managed by the State of Montana Board of Investments Montana Common Stock Pool as of June 30, 1987 and 1986, and the related Statement of Investment Income and Distributions and Statement of Changes in Investments Managed for the two fiscal years then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to in paragraph one present fairly the investments managed by the State of Montana Board of Investments Montana Common Stock Pool as of June 30, 1987 and 1986, and its investment income and changes in its investments managed for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Respectfully,

A handwritten signature in cursive script, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 6, 1987

STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA COMMON STOCK POOL
STATEMENT OF INVESTMENTS MANAGED
JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Cash	\$ 93	\$ 13,811
Dividend receivable	493,244	472,300
Interest receivable	15,565	626,053
Investments managed at current value (cost of \$150,293,791 in 1987 and \$138,500,821 in 1986)	<u>253,608,907</u>	<u>219,433,880</u>
TOTAL ASSETS	<u>254,117,809</u>	<u>220,546,044</u>
Income due participants	(16,005)	(3,442)
NET ASSET VALUE	<u>\$254,101,804</u>	<u>\$220,542,602</u>
Units outstanding	114,289	114,265
Unit value	\$ 2,223.33	\$ 1,930.10

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA COMMON STOCK POOL
STATEMENT OF INVESTMENT INCOME AND DISTRIBUTIONS
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Interest income	\$10,402,560	\$9,873,741
Income due participants, beginning of year	<u>3,442</u>	<u>2,227</u>
Income available for distribution	10,406,002	9,875,968
Distribution (Note 2)	<u>(10,389,997)</u>	<u>(9,872,526)</u>
Income due participants, end of year	<u>\$ 16,005</u>	<u>\$ 3,442</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA COMMON STOCK POOL
STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE FISCAL YEARS ENDED JUNE 30, 1987 AND 1986

	<u>1987</u>	<u>1986</u>
Net asset value, beginning of year	\$220,542,602	\$173,579,122
Value of units purchased by participants (Note 2)	46,118	6,969,558
Value of units sold by participants (Note 2)	-0-	(57,113)
Changes in current value of investments managed	<u>33,513,084</u>	<u>40,051,035</u>
Net asset value, end of year	<u>\$254,101,804</u>	<u>\$220,542,602</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS

MONTANA COMMON STOCK POOL

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 1987 AND 1986

1. HISTORY AND ORGANIZATION

The state of Montana Board of Investments (board) was created by an act of the Legislature to invest and manage the state of Montana's investment funds on a centralized basis. The Montana Common Stock Pool (Mont-Comp) was created in order to allow smaller retirement funds the opportunity to participate in the equity market via a diversified pool.

Mont-Comp was created as of July 1, 1980 by the transfer from All Other Funds of all common stock owned by the Public Employees' Retirement System and the Teachers' Retirement System.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Public Employees' Retirement System and the Teachers' Retirement System transferred virtually all stock owned into Mont-Comp at the start-up date and were issued units according to the market value of their contribution, retaining their original total cost basis.

The initial unit value as of July 1, 1980 was \$1,000. Unit values thereafter are calculated once a month at the close of the last business day of the month based upon the market value of the Mont-Comp equity holdings and other assets. Participants may only buy or sell units on the first business day of each month.

Mont-Comp distributes to each participant investment income on the last business day of each month. This distribution is based on the full accrual basis so that all dividends and interest accrued during the month are returned to the participants based on the number of their units outstanding.

3. SECURITIES LENDING

The board has an agreement with the Chase Manhattan Bank (Chase) whereby Chase would loan to other entities securities managed by the board.

During the period the securities are on loan, the board receives a fee and Chase must maintain collateral equal to 102 percent of the market value of the securities loaned. The board retains all rights and risks of ownership during the loan period. Included in interest income in the accompanying financial statements is \$9,727 for the year ended June 30, 1987 and \$46,974 for the year ended June 30, 1986 of income from securities lending activities. At June 30, 1987 approximately \$1,171,775 and at June 30, 1986 approximately \$12,082,914 of securities included in these financial statements had been loaned by Chase to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized to give an indication of the level of risk assumed at June 30, 1987. Category 1 includes investments that are insured or registered or securities that are held by the entity or its agent in the entity's name. Category 2 includes uninsured or unregistered securities held by the counterparty trust department or agent in the entity's name (i.e., securities on loan).

<u>MTCP</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Total Carrying Value</u>	<u>Total Market Value</u>
Corporate Stocks	\$73,923,316	\$1,171,775	\$75,095,091	\$178,410,207

5. SUBSEQUENT EVENT

Effective July 1, 1987, Chapter 581, Laws of 1987, merged the Economic Development Board with the Board of Investments. A new nine-member board was established to oversee the entire investment program.

STATE OF MONTANA
BOARD OF INVESTMENTS

SCHEDULE OF INVESTMENT INCOME
FOR THE FISCAL YEAR ENDED JUNE 30, 1987

(Supplementary Information)

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122



SCOTTA SEACAT
LEGISLATIVE AUDITOR

DEPUTY LEGISLATIVE AUDITORS

JAMES GILLETT
FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the All Other Funds, STIP, and Montana Common Stock Pool financial statements of the Montana Board of Investments for the two years ended June 30, 1987 and 1986 as listed in the table of contents, and have issued our reports thereon dated October 6, 1987. Our examination was made in accordance with generally accepted auditing standards and accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Our examination was made for the purpose of forming an opinion on the basic financial statements of the Board of Investments for the All Other Funds, STIP, and Montana Common Stock Pool investment management programs taken as a whole. The accompanying Schedule of Investment Income is presented for additional analysis and disclosure purposes and is not a required part of the basic financial statements for the Board of Investments. The schedule has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, except for the effect of deferring gains and losses on bond swaps in the All Other Funds investment program as explained in the second paragraph of our report on All Other Funds, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Respectfully,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 6, 1987

STATE OF MONTANA BOARD OF INVESTMENTS
SCHEDULE OF INVESTMENT INCOME (Schedule B)
FOR THE FISCAL YEAR ENDED JUNE 30, 1987

Fund	Cash ⁽¹⁾	Current Amortization	Net Deferred Gain (Loss) on Bond Swaps	STIP Income	Mont-Comp Income	Modified Income	Accrued ⁽²⁾ Income	Net Income
Teachers' Retirement System	\$ 42,875,283	\$ 597,972	\$ (686,236)	\$ 639,418	\$ 4,587,682	\$ 48,014,119	\$ 1,103,318	\$ 49,117,437
TRS-Minnie Fullam	(11)			2,598	1,818	4,405	(193)	4,212
Public Employees' Retirement System	55,524,134	797,198	(1,008,375)	1,196,887	5,244,234	61,754,078	1,685,667	63,439,745
Firefighters' Unified Retirement Sys.	1,776,041	(27,588)	32,019	55,979	73,183	1,909,634	74,551	1,984,185
Game Wardens' Retirement	624,940	3,875	(11,068)	25,526	60,455	703,728	31,978	735,706
Highway Patrol Retirement	1,495,793	18,332	(14,103)	76,060	107,546	1,683,628	95,973	1,779,601
Judges' Retirement	737,130	1,569	959	26,081	66,728	832,467	44,453	876,920
Police Reserve	2,178,915	(8,485)	(1,240)	132,729	94,183	2,396,102	123,459	2,519,561
Sheriffs' Retirement	1,907,286	(8,222)	5,354	99,508	113,183	2,117,109	130,302	2,247,411
Social Security	232,420	603		6,041		239,064	(33,062)	206,002
Volunteer Firemen	501,665	1,394	2,585	23,294		528,938	865	529,803
Uninsured Employers				68,005		68,005	(4,195)	63,810
Subsequent Injury	203,143	9,282	(6,891)	71,902		277,436	(29,543)	247,893
Workers' Compensation	6,057,390	265,055	(452,109)	15,683		5,886,019	(292,227)	5,593,792
Common School Interest & Income	274,396			339,474		613,870		613,870
Trust & Legacy	23,057,544	663,551	(698,445)			23,022,650	272,999	23,295,649
Coal Tax Park Acquisition	1,650,498	(55,330)	24,115	160,598		1,779,881	56,689	1,836,570
Permanent Coal Trust	33,159,870	(44,247)	172,982	2,522,067		35,810,672	175,192	35,985,864
Resource Indemnity	6,835,099	89,776	(22,905)	353,250		7,255,220	(49,399)	7,205,821
Educational Trust	11,986,023	(59,144)	50,089	900,480		12,877,448	(898,748)	11,978,700
Rail Construction Loan				166,705		166,705	(15,682)	151,023
BN Geraldine Settlement Connector	178,015	823		143,443		322,281	(89,509)	232,772
BN Geraldine Settlement				167,557		167,557	(12,835)	154,722
Exxon Oil Overcharge	632,177			78,025		710,202	(159,095)	551,107
Airport Loans Special Revenue				92,506		92,506	(9,483)	83,023
Agency Insurance	745,403	6,023		165,100		916,526	(310,143)	606,383
Group Benefits	693,677	13,967		999,893		1,707,537	(43,771)	1,663,766
Treasurers'	10,672,424			2,588,885		13,261,309	(501,915)	12,759,394
Highway BANS	1,193,686			3,674		1,197,360	(589,483)	607,877
Highway ERA	482,343					482,343	(482,876)	(533)
Highway Revenue Capitalized Interest				(993)		(993)	(8,088)	(9,081)
Highway Revenue Bond Proceeds	945,205	2,082		111,198		1,058,485	(425,860)	632,625
Highway Revenue Bond Debt Service	2,020,188	10,303		100,846		2,131,337	(594,145)	1,537,192
Highway Complex Sinking	46,610	34		13,393		60,037	(4,866)	55,171
Highway Revenue Bond Construction	375,922			172,532		548,454	(165,213)	383,241
Rock Creek Mitigation	68,456	133		14,741		83,330	21,367	104,697
DNRC Water Development				61,846		61,846	(8,180)	53,666
Debt Service Reserve	324,225	2,875		7,619		334,719	(4)	334,715
1984 Series A Bond Proceeds	28,081			195,375		223,456	(12,788)	210,668
1985 Series B Bond Proceeds	177,142	208		167,370		344,720	1,093	345,813
Real Property Trust	83,047	1,644		4,620		89,311	963	90,274
1985 Series A Bond Proceeds	17,764			11,912		29,676	140	29,816
Historical Society Donations	6,369			1,857		8,226	(3,263)	4,963

STATE OF MONTANA BOARD OF INVESTMENTS
SCHEDULE OF INVESTMENT INCOME (Schedule B)
FOR THE FISCAL YEAR ENDED JUNE 30, 1987
(continued)

Fund	Cash ⁽¹⁾	Current Amortization	Net Deferred Gain (Loss) on Bond Swaps	STIP Income	Mont-Comp Income	Modified Income	Accrued ⁽²⁾ Income	Net Income
Charles Bair Trust	\$ 16,310			\$ 4,680	\$ 3,364	\$ 24,354	\$ (1,210)	\$ 23,144
Series 1981				24,971		24,971	(1,287)	23,684
Capitol Renovation	173,843			61,691		235,534	(168,335)	67,199
Long Range Building	237,581			167,265		404,846	(66,182)	338,664
Long Range Building Bonded Program	439,365	\$ 143		169,593		609,101	(337,891)	271,210
1983 Fish, Wildlife & Parks Program				53,086		53,086	(5,598)	47,488
Everett Lynn Trust	16,743	55		2,532		19,330	(4,852)	14,478
1985 Fish, Wildlife & Parks Program	268,070			179,714		447,784	(103,925)	343,859
Nongame Wildlife	430			240		670	(82)	588
Hail Insurance	40,647	32		236,880		277,559	(19,322)	258,237
Coast Trading Trust	8,594			3,681		12,275	(1,951)	10,324
Renewable Resource Development				62,534		62,534	(6,145)	56,389
Weed Control Trust	27,660	199		735		28,594	5,587	34,181
Forest Reserve	45,241					45,241		45,241
Montana Tech and Potter Trust	(12)			43,918	3,545	47,451	(3,446)	44,005
Montana State University	21,904			344,366		366,270	(29,755)	336,515
Eastern Montana College	10,954			15,411		26,365	(1,006)	25,359
Dixon Endowment	3,818					3,818		3,818
Caras Endowed Scholarship					91	91		91
Bradley Trust					4,364	4,364	6	4,370
Teakle Trust					4,000	4,000	5	4,005
General Trust					1,455	1,455	1	1,456
Merritt-Wheeler Memorial					893	893	1	894
Water & Waste-water Operators				1,968		1,968	(152)	1,816
Livestock-Inspection & Control				154,163		154,163	(9,055)	145,108
Livestock-Animal Health ERA				40,836		40,836	(2,543)	38,293
Lands & Resource Development				(5,428)		(5,428)	(2,975)	(8,403)
Wheat Research & Marketing				13,779		13,779	(89)	13,690
Board of Oil & Gas				46,219		46,219	(2,307)	43,912
Montana Rural Rehabilitation				30,517		30,517	(1,193)	29,324
Local Impact				11,190		11,190	(16,359)	(5,169)
Flood Insurance				109,129		109,129	(2,334)	106,795
Agriculture-Commercial Fertilizer				5,040		5,040	(408)	4,632
Agriculture-Commercial Feed ERA				3,511		3,511	(246)	3,265
Agriculture-Grain Services				5,451		5,451	(156)	5,295
Agriculture-Alfalfa Seed				330		330	(39)	291
Foster Children				863		863	(178)	685
Woodville Highway Replacement				3,441		3,441	(2,050)	1,391
Guaranteed Student Loan Reserve				303,856		303,856	(18,069)	285,787
Workers' Compensation Building				111,178		111,178	(5,068)	106,110

STATE OF MONTANA BOARD OF INVESTMENTS
SCHEDULE OF INVESTMENT INCOME (Schedule B)
FOR THE FISCAL YEAR ENDED JUNE 30, 1987
(continued)

<u>Fund</u>	<u>Cash</u> ⁽¹⁾	<u>Current Amortization</u>	<u>Net Deferred Gain (Loss) on Bond Swaps</u>	<u>STIP Income</u>	<u>Mont-Comp Income</u>	<u>Modified Income</u>	<u>Accrued Income</u> ⁽²⁾	<u>Net Income</u>
Job Service Building				\$ 32,386		\$ 32,386	\$ (1,232)	\$ 31,154
Moderate Rehabilitation Reserve				5,889		5,889	(597)	5,292
Operating Reserve				48,057		48,057	(4,082)	43,975
Montana Instate Investments				1,595,112		1,595,112	(112,832)	1,482,280
Section 155 Grant				27,457		27,457	(3,665)	23,792
Warner Amendment				8,471		8,471	(809)	7,662
Group Insurance				299,537		299,537	(24,213)	275,324
1985 WMC				80,551		80,551	(7,751)	72,800
HB 820 Debt Service				16,144		16,144	(1,310)	14,834
Oil Overcharge				997		997	(205)	792
Amoco Oil Overcharge				528		528	(55)	473
Northern Montana College				36,288		36,288	(710)	35,578
University of Montana and William Murphy	\$ 1,178			387,886	\$ 23,273	412,337	(23,017)	389,320
Western Montana College				8,346		8,346	(234)	8,112
Other STIP - Local Governments				1,920,611		1,920,611	6,882	1,927,493
1987 Highway Debt Service Reserve	(214)	\$ 5,369		2,177		7,332	65,366	72,698
1987 Highway Proceeds	48,339	52,529		471,198		572,066	559,013	1,131,079
Diamond Shamrock				13,419		13,419		13,419
State 911 Program				920		920	49	969
Stripper Wells	166,157			23,158		189,315	113	189,428
Anhydrous Ammonia				448		448		448
DNR Weed Control				4,655		4,655	11	4,666
Noxious Weed Control				2,533		2,533	5	2,538
Vouchers Reserve				76		76	1	77
1987 Highway Debt Service				8,618		8,618		8,618
1987 Highway Debt Issuance				1,480		1,480	4	1,484
1985 Series B Debt Service				2,357		2,357	38	2,395
1985 Series A Debt Service Reserve				6,820		6,820		6,820
Board of Oil & Gas II				465		465	2	467
Protested Property Tax-BN				249,428		249,428	2,433	251,861
Protested Property Tax Soo Lines				95		95	1	96
Protested Property Tax UP				3,018		3,018	30	3,048
Lula Mae Clay Endowment				159		159	2	161
TOTALS	<u>\$211,294,901</u>	<u>\$2,342,010</u>	<u>\$(2,613,269)</u>	<u>\$19,450,308</u>	<u>\$10,389,997</u>	<u>\$240,863,947</u>	<u>\$(1,280,927)</u>	<u>\$239,583,020</u>

(1) Cash Receipts from All Other Funds investments

(2) Net change of the fiscal year 1987 and fiscal year 1986 investment income accruals

STATE OF MONTANA
BOARD OF INVESTMENTS

AGENCY REPLY

DEPARTMENT OF COMMERCE
BOARD OF INVESTMENTS



TED SCHWINDEN, GOVERNOR

CAPITOL STATION

STATE OF MONTANA

(406) 442-1970

HELENA, MONTANA 59620

January 18, 1988

Scott A. Seacat, Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, MT 59620

Dear Mr. Seacat:

The following is our response to your recommendations resulting from the audit of the Board of Investments for the fiscal year ending June 30, 1987.

Recommendation #1

- (a) We concur and in fact there had been regular briefings for the Board on the status of the Boeing project. However, since the issue was the subject of potential litigation, there was no mention of it in the minutes. We were also concerned about disclosure of the alternate systems development project, since that could have affected negotiation of a settlement with Boeing. However, the Board had been regularly informed of the plans to move ahead.
- (b) We concur with the recommendation to document the soft dollar arrangement in the Board minutes. The February 27, 1987 and March 27, 1987 minutes discuss soft dollar arrangements generally, and the WESCO soft dollar arrangement specifically.

Recommendation #2

- (a) We concur.
- (b) We concur. The requisite documentation will be completed no later than March 31, 1988.
- (c) We concur. The equipment will be tagged.

Scott A. Seacat
January 18, 1988
Page Two

Recommendation #3

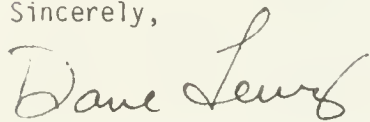
We concur. The first draft has already been delivered.

Recommendation #4

We do not concur with the recommendation to record bond swap transactions in accordance with generally accepted accounting principles and state accounting policy. Bond swaps are not a "completed transaction" but rather an exchange of similar securities. The Board has consistently deferred gains and losses for all entities since its inception in 1971. Accounting information with respect to bond swaps is provided each respective agency and is fully disclosed in the Board's Annual Report. We believe presentation of all funds in a consistent manner is the best way for the Board to operate.

We want to thank the audit manager and his staff for the professional manner in which they conducted the audit.

Sincerely,

A handwritten signature in cursive script that reads "Dave Lewis".

Dave Lewis
Executive Director

